

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495. (This is a GIL).

November 13, 2001

Dear Xxxxx:

This letter is in response to your letter dated September 14, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

We are requesting a ruling on our findings from the Illinois Department of Revenue on the taxability of the transactions outlined below. Due to Company X's current operations and billing methods, your ruling could have a material impact; therefore, we respectfully request an expedited response.

Background

Company X is not in an ongoing dispute with the State of Illinois regarding the issues stated below. Currently, there is not an active audit, protest, or appeal involving Company X and the State of Illinois. Company X is currently registered with the Illinois Secretary of State and has received approval for a competitive local exchange status.

Company X, a single member Limited Liability Corporation, was organized in 2000 in a state other than Illinois. Company X was formed through a contribution of pre-existing fiber optic cable and other related assets from its sole member. Included within the transfer of these assets was a pre-existing burden over the property in the form of an Indefeasible Rights of Use (IRU). Company X is subject to multiple IRU agreements for dark fiber that were initially contracted for by the previous entity. The third parties benefiting from these IRU agreements will continue to have exclusive rights to utilize the dark fiber optic cable with Company X providing any necessary maintenance. Company X did not, and will not, receive any payments from the pre-existing IRU's as the payments had been received prior to the formation of Company. The pre-existing IRU revenue was recognized on the final tax returns of the original owners; however, Company X will be recognizing, for book purposes only, the income related to the IRU's

for the remainder of the agreements term. Company X will expand and enter into new IRU agreements for its own benefit.

Company X has a network of fiber optic cables. The fiber optic cable is a collection of fiber strands contained in color-coded buffer tubes with protective outer coverings. The 'fiber strand' refers to a glass strand(s) protected by color-coded buffer tubes, which transmit a communication signal along the glass strand to form pulses of light. The fiber is referred to as 'dark fiber' until it has optronics or electronics attached to it to initiate the optic pulses. The fiber optic cable may be aerial or underground depending on the specific location.

Company X enters into agreements with third parties for a fee paid at the date of execution in which they grant an IRU for the use of fibers (dark fiber only) for a period normally of 20 years with a right to renew. The IRU agreement also grants the non-exclusive right to use tangible and intangible property including cable sheathing, troughing, pedestals, slack containers, and related equipment, but excluding any electronic or optronic equipment. The third party obtaining the IRU will attach equipment to 'light' the fiber at an optical splice point.

The IRU fee is a fixed cost based on the number of miles of cable being utilized. In addition, an annual maintenance fee will be assessed also based on the number of miles of optic fiber placed under agreement. Each company will be responsible for entering into a co-location agreement with Local Exchange Carriers for its wholly owned or IRU fibers. All of Company X's fiber optic strands not under an exclusive IRU agreement remain 'dark fiber' until a third party contracts for their exclusive usage and 'lights' the cable with their own equipment. Additionally, Company X may light the fiber with their own equipment and subsequently sell capacity to another telecommunications company for resale or an end user. When Company X sells capacity, the customer is able to transmit communications 'traffic' over the fiber optic cable; however, Company X agreement does not involve the measurement of 'traffic volume' being sent via the optic cable.

Due to the approval by the State of Illinois to be treated as a telecommunications carrier, Company X has been allowed to provide all forms of competitive facilities-based services as well as resold local exchange and inter-exchange telecommunications services including direct-dialed message, telecommunications, caller ID and 800 services. Local exchange services will include basic residential exchange services (local exchange flat rate, measured rate service, operator access, etc.). Local exchange services would also include residential customer and class features (call waiting, caller ID, call forwarding, etc.). These services will also be available for the business exchange market. In addition, voice messaging, ancillary services (911) and directory assistance will be available. Company X will interconnect to LEC/ILEC central offices, carrier hotels, Universities, Colleges and large commercial entities. Large entities with sufficient bandwidth demands will be serviced via 'type 2' connections through Company X's co-location in the LEC/ILEC central offices and carrier hotels.

Ruling Requested

Company X has been approved by the State of Illinois to be treated as a telecommunications carrier. We are requesting a ruling regarding the applicability of

sales, use or telecommunications tax and the necessary, if any, reporting requirements for a telecommunications utility.

We would specifically like you to address the following issues and our findings:

Issue #1

Would the initial payment for IRU agreements and/or maintenance fees on dark fiber entered into by the previous entity and transferred to Company X be subject to sales, use or telecommunications tax? In addition, are new IRU agreements and/or maintenance fees entered into by Company X subject to sales, use or telecommunications tax?

Issue #2

If the fee paid for the dark fiber under the IRU were deemed to be a rental, would the rental fee be subject to sales or use tax? If the IRU fee were deemed to be a rental would it impact the application of sales or use tax on acquisition of the cable and related installation materials? Does the fiber optic cable being aerial and/or underground impact the application of sales or use tax on acquisition?

Issue #3

If Company X purchases optical equipment to light the fiber and subsequently sells capacity to other carriers for resale what, if any, sales or use tax will be required to be charged and remitted on the sale of capacity? In addition, would Company X be required to pay sales tax on acquisition of the optical equipment? If lighted fiber optic cable capacity was provided to an end user would the transaction be subject to sales, use, or telecommunications tax?

Definitions Under Current State Law

'Telecommunications, in addition to the usual and popular meaning, includes, but is not limited to, messages or information transmitted through use of local, toll and wide area telephone service, channel services, telegraph service,or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber optics, laser microwave ... or similar facilities. Telecommunications will not include the purchase of telecommunications by a telecommunication service provider for use as a component part of service provided by him to the ultimate retail consumer who originates or terminates the taxable end-to-end communications.'²

Illinois imposes a telecommunications tax on the gross charge for telecommunications that originate or are received in Illinois and charged to an Illinois address and all services and equipment provided in connection with the telecommunications. Telecommunications companies are not subject to the Illinois sales and use tax on the gross charge for service but are subject to the Telecommunications Excise Tax.

Telecommunications Equipment

Gross charge has been defined as the amount paid for the privilege of origination or receiving telecommunications in this State and for all services and equipment provided

in connection by the retailer.³ Gross charges do not include charges for customer equipment, including such equipment that is leased or rented by the customer from any source, when the charge is disaggregated and separately identified from other charges. Customer equipment includes, but is not limited to, all items generally classified as customer equipment or terminal equipment, such as telephones, station sets, dialers, modems PBX's, inside wiring, facsimile machines, pagers and non-electronic associated items such as documentation. If customer equipment, including maintenance and miscellaneous services is leased to a customer or group of customers it must be disaggregated or separately identified in order to be exempt from the Telecommunications Excise Tax and Retailers' Occupation or Use Tax.

Rental

In general, the rental of personal property is not subject to Illinois Retailers' Occupation Tax (ROT). Lessors are deemed end users of the property to be leased. [IAC 130.220.] As end users of the tangible personal property located in Illinois, lessors owe use tax on their acquisition cost of leased property.

Tangible Property Versus Realty

In evaluating if the rental property is tangible personal property versus realty, Reg. § 130.2075, provides that tangible personal property taken off the market and affixed in a manner as to convert the property into real estate is determined to be realty. Sales of building materials, fixtures and other tangible personal property to contractors, builders or developers for conversion into realty are taxable. [IAC 130.2075(a)(1).] Supplies sold to contractors, builders or developers for use or consumption rather than for incorporation into real property are also taxable. [IAC 130.2075(a)(2).]

Previously Acquired Assets

Assets acquired may be treated as an isolated or occasional sale under Section 130.110. A company may sell its assets used in business, and that are no longer needed, without incurring Retailers' Occupation Tax liability.

Maintenance Agreements

A maintenance agreement that is not included as part of the selling price of tangible personal property, but is sold as a separate agreement for a predetermined fee is not subject to Retailers' Occupation Tax and Use Tax. The serviceman will be subject to tax on the cost of materials transferred incident to the completion of the maintenance agreement.⁴

Sale for Resale

Per Law § 5/8-11-17 telecommunication services resold to other carriers are exempt from telecommunications tax. In addition, tax does not apply to the receipt from sales of tangible personal property for purposes of resale.⁵

Conclusion

In regards to the applicable statutes and regulations researched, there has not been any clear guidance found on the issues described above. Based on a review of many statutes, we have concluded that Illinois could potentially treat the new IRU agreements as a lease of tangible personal property (fiber optic strands) with the initial acquisition of equipment subject to use tax. A review of IAC 130.220 appears to support that the IRU agreement for 'dark fiber' could be classified as a rental of tangible personal property for the aerial cable and related equipment. Due to part of the fiber optic cable being buried it appears this may be deemed an affixation to realty with the contractor subject to sales or use tax on the acquisition of the materials. [IAC 130.2075.] However, the applicability of use tax to the acquisition cost of the property for the new agreements and agreements transferred from the previous entity should be separately evaluated.

In regard to the IRU's acquired from the previous entity, the transfers of assets were treated as a tax-free transaction under the argument that they were transferred to Company X with the intention of continuing the business activities of the previous entity. It is assumed that the real property and non-inventory tangible personal property acquired from the previous entity were acquired in an isolated transaction not made in the ordinary course of the transferor's business and should not be subject to sales tax.

Based on a review of the statute, we have concluded the IRU agreement for 'dark fiber' would be classified as a charge for equipment not to be included the gross charge subject to the Telecommunications Excise Tax. [495.100(b).]

Due to the fact that this is a uniform system encompassing both tangible personal property and real property, we believe that for the new IRU agreements entered into by Company X and third parties the application of law would not subject the rental fee to the Telecommunications Excise tax, the fiber optic cable would be considered to be tangible personal property and the rental fee would be exempt from the Retailers Occupational Tax under IAC 130.220. As leased tangible personal property equipment, the fiber optic cable and related installation supplies would be subject to sales or use tax upon acquisition. In the case that the State would treat the uniform system as real property, the fiber optic cable and related installation supplies would be deemed an affixation to realty with the contractor subject to sales or use tax on the acquisition of the materials. [IAC 130.2075(a)(2).]

Based on a review of the statute, the annual maintenance fee will not be subject to Retailers Occupation tax or telecommunications tax; however, the materials will be subject to sales or use tax on acquisition. The State telecommunications infrastructure maintenance fees (TIMFs) could potentially be applied to the gross charge. However, based on our analysis, Company X's IRU for dark fiber would not have a gross charge subject to the telecommunications tax; therefore, they would not be subject to this fee.

When Company X engages in the sale of capacity by lighting the optic fiber, we contend the capacity is not tangible personal property, but instead is a service. Law § 5/8-11-1 provides that the service would be exempt from both the Telecommunications Excise tax and Retailers Occupation tax as a sale for resale. However, the equipment used to light the fiber would be subject to sales or use tax upon acquisition. If Company X sells to the end consumer, they would be subject to the telecommunications excise tax and related State Telecommunications Infrastructure Maintenance Fees.

If you have any questions regarding this letter ruling request, please contact me.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (2000 State Bar Edition). The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (2000 State Bar Edition).

From the limited information contained within your letter, it is difficult to determine the nature of the transaction involving the purchase of the fiber optic cable. It appears that the fiber optic cable was acquired in a transaction that would be considered an occasional sale. An occasional sale is where the seller is not holding himself or herself out to be a retailer of the property purchased. If this were the case, the transaction would not result in tax liability being incurred. See Section 130.110 for further information.

When fiber optic cable is permanently attached to real property, whether installed underground or above ground to telephone poles, it becomes real property for sales tax purposes and the construction contractor owes Use Tax on his cost price for such cable. Leases of dark fiber optic cable are leases of real property for sales tax purposes. Leases of such dark fiber optic cable are also not subject to Telecommunications Excise Tax.

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

Pursuant to Section 495.100(a), "gross charge" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money, whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of material used, labor or service cost or any other expense whatsoever.

Maintenance agreements for the dark fiber optic cable described above are maintenance agreements for real property for sales and use tax purposes. As such, persons who perform the maintenance may be either categorized as construction contractors or as servicemen depending on the circumstances. The Department would need more specific information regarding these agreements in order to make such a determination.

When the company purchases optical equipment to light the fiber optic cable in order to sell capacity to other carriers for resale, it owes Use Tax on the cost price of the equipment. When the company sells capacity to other carriers for resale, it is selling telecommunications for resale and would have to document that the sales are for resale. If the lighted fiber optic cable capacity were provided to an end user, Telecommunications Excise Tax would be incurred.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.

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² Law § 5/8-11-17(c)(12).

³ Reg. § 495.100

⁴ Reg. § 495.100(b)

⁵ Section 130.120